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ABSTRACT

Hearings on the question of debt collection on student loans are presented. It is noted that in 1981 the Department of Education decided that collections on student loans would be shifted from the public to the private sector. The following concerns are addressed: the reasons for the Department's decision to transfer collection of defaulted student loans to private contractors; the possible negative effects of a hiatus in collections during the process of transferring collections from the federal to the private sector; the relative effectiveness of the private sector collection agencies compared to the Department of Education's collection efforts; and the contents of the Department's request for proposals and the rules or regulations that the Department is developing to insure proper conduct on the part of the private collection agencies. Findings of a 6-week study of the debt collection process and the cost effectiveness of federal staff compared to two prototype collection agencies' efforts are summarized. In addition, departmental problems regarding student aid programs are identified, and the debt collection bill proposed in H.R. 2543 is discussed. (SW)

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OVERSIGHT ON STUDENT LOAN COLLECTIONS

ED234686

HEARING

BEFORE THE

SUBCOMMITTEE ON POSTSECONDARY EDUCATION

OF THE

COMMITTEE ON EDUCATION AND LABOR HOUSE OF REPRESENTATIVES

NINETY-SEVENTH CONGRESS

FIRST SESSION

HEARING HELD IN WASHINGTON, D.C. ON MAY 19, 1981

Printed for the use of the Committee on Education and Labor

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OVERSIGHT ON STUDENT LOAN COLLECTIONS

TUESDAY, MAY 19, 1981

HOUSE OF REPRESENTATIVES,
SUBCOMMITTEE ON POSTSECONDARY EDUCATION,
COMMITTEE ON EDUCATION AND LABOR,
Washington, D.C.

The subcommittee met, pursuant to call, at 9 a.m., in room 2257, Rayburn House Office Building, Hon. Paul Simon (chairman of the subcommittee) presiding.

Members present: Representatives Simon and Erdahl.

Staff present: Maryln McAdam, counsel, and John Dean, minority counsel.

Mr. SIMON. The subcommittee hearing will come to order.

We are holding a hearing on the question of debt collection in the student loan area. On March 18, 1981, the Secretary of Education, Terrel Bell, who is universally respected by this subcommittee, made an announcement that collections would be shifted to the private sector. He also made clear that the Federal collectors have done a good job and we are moving in the right direction.

The subcommittee is not trying to set up a confrontational situation, but we have some concerns. I would say these concerns are primarily in four general areas:

The reasons for the Department's decision to transfer collection of defaulted student loans to private contractors;

The possible negative effects of a hiatus in collections during the process of transferring collections from the Federal to the private sector;

The relative effectiveness of the private sector collection agencies compared to the Department of Education's collection efforts; and

The contents of the Department's request for proposals [RFP] and the rules or regulations which the Department is developing to insure proper conduct on the part of the private collection agencies.

I think that sums up where we are.

We are anxious to see that debt collection continues on an efficient basis, and these oversight hearings will be taking a look at that.

[The chairman's opening statement follows:]

OPENING STATEMENT OF HON. PAUL SIMON, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF ILLINOIS, AND CHAIRMAN, SUBCOMMITTEE ON POSTSECONDARY EDUCATION

The Subcommittee on Postsecondary Education will begin oversight hearings today on the collection of defaulted Guaranteed Student Loans (GSL) and National Direct Student Loans by the Department of Education. This week's hearings will

(1)

focus on the Department's decision to transfer collection of defaulted student loans under the Guaranteed Student Loan Program and the National Direct Loan Program from federal collectors to private contracting agencies.

On March 18, 1982, Secretary of Education Terrel Bell announced in a memorandum to the Acting Assistant Secretary for Postsecondary Education that student loan collections would be transferred to the private sector. In making his announcement, the Secretary stated that "Federal collectors have proven to be very efficient." He further acknowledged that of the 600,000 Guaranteed Student Loans in default over the past four years, nearly 90 percent had been resolved. These statements were consistent with Secretary Bell's testimony before this subcommittee on March 11, 1981, when he stated that the Department continued to see improvements "in loan default collections, especially in the federal portion of the Guaranteed Student Loan Program," According to his testimony at that hearing, "amounts collected by federal collectors have increased from about $9 million in fiscal year 1977 to almost $38 million in fiscal year 1980."

Considering this established and in fact admirable success record, I have serious reservations about the transfer of the collections process to the private sector. The specific concerns lay in four general areas:

The reasons for the Department's decision to transfer collection of defaulted student loans to private contractors;

The possible negative effects of a hiatus in collections during the process of transferring collections from the federal to the private sector;

The relative effectiveness of the private sector collection agencies compared to the Department of Education's collection efforts; and

The content of the Department's request for Proposals (RFP) and the rules or regulations which the Department is developing to ensure proper conduct on the part of the private collection agencies.

The debate over the collection of defaulted student loans is not a new one. In 1977, the Department of Health, Education and Welfare began making a concerted effort to collect on monies owned to it under the student loan programs. Over that five-year period hearings have been held by the Subcommittee on Intergovernmental Relations and Human Resources and by this subcommittee to monitor how that collection effort was progressing. When HEW initiated its collection activities over 344,000 student borrowers had defaulted on their Guaranteed Student Loans. That figure translated into $500 million and a default rate of nearly 13 percent.

The collection of NDSL loans has not progressed as well. The federal government did not become actively involved in the collection of those defaulted loans until 1979. Consequently, there is still a major backlog of defaulted NDSL loans to be addressed.

I am further concerned that the Department of Education does not take any action to limit the ability of higher education institutions to refer NDSL loans to the federal government. Such an action could cause some institutions to become ineligible to receive funds under the NDSL program because of high default rates.

In hearings held in July of 1978 by the Intergovernmental Relations and Human Resources Subcommittee, former Secretary of HEW Joseph Califano testified that federal collectors were converting defaulted GSL accounts to repayment status at a rate of 1,200 per week. By June of 1979, the default rate had dropped to 9 percent and the number of defaulted accounts which had been paid in full had reached 41,963, according to HEW statistics. Current Department of Education figures show that the default rate has dropped to 8.2 percent, a figure somewhat lower than the national average default rate on all loans. Most importantly, it demonstrates that about 92 percent of all GSL borrowers do repay their loans.

It has taken the Department of Education several years to develop an efficient collection capability. Before irreversible actions are taken to dismantle that capability, we feel it is imperative that the ramifications of such a move be thoughtfully reviewed. That is the purpose of convening these hearings today.

We are fortunate to have with us today a number of witnesses who are familiar with various aspects of the student loan collection process and the Department's decision to transfer that process to the private sector.

One of our witnesses today will be our distinguished colleague on the full committee, Representative Jim Jeffords of Vermont. In March of this year Mr. Jeffords introduced a bill, H.R. 2543, to establish aggressive and effective collection practices with respect to federal loan programs. Title III of that bill deals specifically with collection practices for defaulted student loans, and outlines general procedures to be followed in the collection of those defaulted loans.

At this time I would like to introduce our first witness, Mr. John Yazurlo, the Acting Inspector General for the Department of Education.

Mr. SIMON. Our first witness is Mr. John Yazurlo, the Acting Inspector General for the Department of Education.

We are pleased to have you here. And I understand you may be accompanied by Donald Nelson. Is that correct?

STATEMENT OF JOHN C. YAZURLO, ACTING INSPECTOR GENERAL FOR AUDIT, DEPARTMENT OF EDUCATION, ACCOMPANIED BY DONALD NELSON

Mr. YAZURLO. He is with me.

Mr. SIMON. I understand you do not have a formal statement. Is that correct?

Mr. YAZURLO. That is correct.

Mr. SIMON. Any informal statement you wish to make at this time we would welcome; then we would like to toss questions at you.

Incidentally, my apologies to my colleague from Minnesota. I wish to call upon you for any comments you may wish to make.

Mr. ERDAHL. I heard a well-known columnist, Jack Anderson, touch on this subject. He indicated this was a program that had worked very well in collecting student defaulted loans, and now the Government was proposing to turn it over to some collection agency which would be costing millions of dollars. I heard this, this morning, as I was coming to the hearing.

I have to be running in and out, but I am sure these hearings will be productive.

Mr. SIMON. The subcommittee is going to pay for his car radio. He keeps up on the news.

Pleased to have you here, Mr. Yazurlo.

Mr. YAZURLO. My present position is Acting Inspector General for Audit. I do not serve in the capacity of Inspector General at this time.

Mr. SIMON. Who does now serve in that capacity?

Mr. YAZURLO. Presently we have a Deputy Inspector General, James Thomas, and he is also the designee; he had previously served as the Inspector General.

Mr. SIMON. If I may ask, was the invitation made specifically to you or to him, and why is he not here?

Mr. YAZURLO. I have not seen the invitation, sir. It is my understanding I was named in the invitation to attend this hearing.

Mr. SIMON. We are very pleased to have you, and please proceed.

Mr. YAZURLO. I have no formal statement to make. I am pleased to be here and will try my best to respond to any questions.

Mr. SIMON. It is my understanding that your office has sent two memoranda to the Department of Education regarding the development of the request for proposals.

Could you explain to the subcommittee the nature of these memorandums and what recommendations you have for implementing this program?

Mr. YAZURLO. Yes, sir, I will be very happy to.

We did in fact send two memorandums with respect to a request for a proposal which as of this time has not been published. It is still undergoing revisions. Our first memo was dated April 14, at which time we expressed certain concerns we had with the draft

proposal and made certain suggestions we felt should be included in the RFP. One of the suggestions was that we felt before defaulted loans are turned over to private contractors there should be some working of those loans by Government employees so as to effect easy collections, and in that way the Government would not have to pay a commission on those to a contractor. By the Government employees doing the initial work, we felt this sort of impetus would result in collections and consequently cut down on the cost of any collections by the contractor.

Second, we proposed that within the RFP, there should be certain specified steps outlined for the contractor to follow with regard to the collection activity, that is for defaulted loans below a certain threshold, certain minimal steps should be followed in attempting collection, and above that threshold, additional steps over and above the minimal ones should be pursued before giving up on the particular loan.

The other main comment we had was to the effect that we were suggesting that the proposal be structured in such a fashion that more than one contractor would receive an award—that way, we would have some competition between the contractors—and that a system be devised to measure then the performance of these contractors so that in future years the business could be channeled to the more effective contractor. Essentially, that was the nature of the comments.

Mr. SIMON. Have you any idea whether your suggestions are being considered at this point?

Mr. YAZURLO. I know they are being actively considered, sir.

There is one point I would like to make. The RFP calls for the award of three contracts. There is nothing in there to preclude the award to more than one contractor.

Our suggestions were along the line to assure that more than one contractor did, in fact, get an award.

Mr. SIMON. I frankly picked up a rumor, I do not know if it is any more than that, that one of the firms that may end up getting a contract is a Canadian firm. Do you know anything about that?

Mr. YAZURLO. No, sir, I have not heard that rumor.

Mr. SIMON. Rumors are frequently not worth a thing, so there may be no truth to that, but it would be a development which will be followed with interest by this subcommittee.

Our colleague from Vermont, Representative Jim Jeffords, has introduced a bill which among other things would require that during the first 6 months of a life of a default program the Government would continue to try to collect. At that point, turn it over to private collectors. It is somewhat along the same line as I sense your suggestion.

Mr. YAZURLO. Yes; it is, although we did not specify a specific timeframe during which the initial working should be done by the Government.

Mr. SIMON. How do you react to the Jeffords proposal?

Mr. YAZURLO. Well, the proposal does coincide with our suggestion. Whether the timeframe is proper, I am not too sure. To me it seems like a stretchout, it is much too long. But I am not in a position to really evaluate.

Mr. SIMON. Have you any idea at this point when regulations and the request for proposal will be released by the Department?

Mr. YAZURLO. No, sir, I do not.

Mr. SIMON. Let me take the liberty, since there is no one else here to object, to ask the Republican counsel if he has any questions he would like to specifically address to the committee.

Mr. DEAN. Yes; just two simple questions.

What is your understanding of the size of the universe of potential contractors? How many firms?

Mr. YAZURLO. I do not recall, sir; it is spelled out in the RFP. I have read it, but I do not recall.

Mr. DEAN. Have you an estimate of how many submissions presently, expressions of interest, have been received by the Department.

Mr. YAZURLO. As to the number of bidders there will be on the proposal?

Mr. DEAN. Yes.

Mr. YAZURLO. I do not know, sir.

Mr. DEAN. Basically, what will be the next step of the Department if no acceptable proposals are received?

Mr. YAZURLO. I would imagine they would follow normal contracting procedures and start to contract all over again.

Mr. DEAN. On the basis of your familiarity of that, what effect will that have on the timetable for releasing term employees?

Mr. YAZURLO. I would expect the timetable would have to be extended to allow sufficient time to go through the process again and make the proper awards.

Mr. DEAN. As a final question: Is there any policy at the Department right now relating to Canadian firms getting a contract from the Department?

Mr. YAZURLO. I am not aware of any policy, sir.

Mr. DEAN. Thank you.

Mr. SIMON. Let me ask you about the timelag problem. There is some concern that we are going to shift this over to private collectors and there will be a time period where instead of a gradual improvement in collections where we are now, there will be slippage. Not only do we have loss of revenue, but we end up with people attacking the program.

One of the attacks made regularly on the student loan programs is the high default rate, which we are gradually now diminishing.

Have you any reflection on this timelag problem that could develop?

Mr. YAZURLO. Well, I personally believe the longer it drags out, it will cause more problems. My feeling is the sooner contracts could be awarded, the better it would be.

Mr. SIMON. I did not make my question clear enough. I am talking about the timelag between—whether it is tomorrow or 6 months, that there is a timelag between the point where the Federal Government is assuming its responsibility and it shifts that responsibility to the private collectors.

In other words, if you were the head of the ABC Collection Agency and you are given a contract, once you get that contract, then you have to employ people, you have to examine the kind of caseload you have, you have to take a look at how you proceed.

What kind of problems do you see there, if any?

Mr. YAZURLO. I am not aware of any, sir. The RFP does request information along those lines as to the capabilities of the contractor's firm to handle the volume of business that is in the RFP.

Mr. SIMON. The RFP does request that. You have a copy of the RFP?

Mr. YAZURLO. I have seen a copy of it. It is still being revised. It has been all marked up.

I venture to say they are planning for an orderly transition, so that problems do not arise during this period.

Mr. SIMON. The plan is obviously for a mix of Federal and private as we move ahead?

Mr. YAZURLO. Yes.

Mr. SIMON. Do you have any feel for what kind of mix we are talking about?

Mr. YAZURLO. No, sir, I do not.

Mr. SIMON. Our colleague from New York has joined us.

Do you have any questions?

Mr. WEISS. Thank you, Mr. Chairman, not at this time.

Mr. SIMON. We thank you very, very much for your testimony.

[The information referred to follows:]

U.S. DEPARTMENT OF EDUCATION,
Washington, D.C., April 24, 1981.

To: The Secretary.
From: John C. Yazurlo, Acting Inspector General.
Subject: RFP for contracting out student loan collections to the private sector.

During our current review of the Office of Student Financial Assistance (OSFA), we have been looking at the RFP which is being prepared for contracting out student loan collections to the private sector. OSFA employees responsible for writing the RFP have included several excellent provisions to ensure the efficiency of the system (e.g. specifying minimum collection steps required for all accounts and providing for ED to retain accounts entering repayment as a result of its initial letter thus avoiding unnecessary collection fees).

There are, however, two related changes we would recommend to maximize the effectiveness of the contract:

Develop specific criteria to measure actual loan collection performance (including the rate of return on the account portfolio and the number of accounts collected). The required quality control plan concentrates on necessary activities and documentation but does not address the desired monetary result, i.e., collection of the defaulted loans.

Require that contracts be awarded to more than one contractor and apportion future accounts to the several contractors competitively based on the prior year's rate of return.

We realize that there is some urgency in publishing the RFP. However, in order to enhance the collection effort, we urge that the RFP contain the suggested measurable performance criteria and provide for more than one contractor to ensure competition.

U.S. DEPARTMENT OF EDUCATION,
Washington, D.C., April 14, 1981.

To: James Moore, Acting Deputy Assistant Secretary for Student Financial Assistance.
From: Director, Fraud Control, Office of Inspector General.
Subject: RFP for contracting out student loan collections to the private sector.

In conjunction with our review of Student Financial Assistance, we have been looking at the loan collection function. In particular, we have reviewed the RFP (dated 3/24/81) which is currently being prepared for contracting out student loan collections to private sector. We have identified several areas where the following changes could be made to improve the effectiveness of the RFP.

Government Creaming—Requiring the regional offices to take the first step of sending to the student debtor a firm letter using the IRS locator service for a current address. The RFP should allow OSFA to retain the amounts collected as a result of the letter. If there is no response to this letter, however, refer it to the contractor. This step may bring substantial repayments with minimal staff effort while avoiding the collection fee.

Specifying required collection steps—Require the contractor to perform specific minimum collection steps on all accounts. Thus, all the debtors will realize that we are interested in collecting their accounts regardless of size. This change will also provide that all debts transferred receive the same minimum attention. Strengthening the RFP in this manner may avoid future disputes with the contractors.

Encourage competiton among several collection agencies to maximize collection efforts—Use strict performance evaluation criteria including rate of return, and then base future referrals on the prior year's performance. This should encourage greater collection efforts.

In addition to the above RFP revisions, there are specific aspects of the current National Direct Student Loan (NDSL) collections that should be addressed.

Preclaims assistance for NDSL—since NDSL's are now being handled similarly to Federally Insured Student Loans (FISLs) preclaims assistance should be considered in an attempt to reduce the number of assignments.

Ensuring that the schools shoulder the responsibility for these loans—Schools which submit for assignment notes which are unsigned should be required to buy them back with follow-up action to confirm replacement of the money into the fund. Similarly the schools should be held accountable for notes when there has been a failure to conduct due diligence prior to assignment.

Including a Penalty of Perjury statement on the Assignment of Defaulted Notes (Form 553). For example: Warning: Any person who knowingly makes a false statement or misrepresentation on this form may be subject to a fine of up to $10,000 or to imprisonment of up to 5 years or to both under provisions of the United States Criminal Code. Such provisions may include, among others, 18 USC 1001.

Requiring that the Social Security Numbers for all NDSL borrowers be kept by the schools and submitted to the Department of Education with any note assigned.

If there are any questions we are available to meet with you and discuss these suggestions. We would appreciate your comments as to whether these suggestions are adopted for the RFP.

DONALD J. NELSON.

DEPARTMENT OF EDUCATION'S ANNOUNCEMENT OF RFP IN COMMERCE BUSINESS DAILY, MAY 4, 1981

H—Private Collection Agency Assistance Under the Federal Insured Student Loan and National Direct Student Loan Programs, will be issued on or about 15 May 81. The objective of this procurement is to assist the Department of Education's Office of Student Financial Assistance in performing collection activities under the Federal Insured Loan and the National Direct Student Loan programs. These activities will include locating and contacting debtors, billing of debtors, processing payments from debtors, maintaining records on accounts, and transmitting collection information to the Department's computerized data base. The contractor will not pursue any debtor through litigation. Three separate contracts will be awarded under this RFP. The work performed under each contract will be nationwide in scope, however, the work for one contract will be performed in Atlanta, Georgia, another in Chicago, Illinois, and another in San Francisco, California. Request for copies of solicitation will be honored if received within 20 calendar days after issuance. Requests received after this period will be filled on a first-come, first-serve basis until the supply is exhausted. Furnish three self-addressed label and list the solicitation number at the bottom of the labels. Individual requests should be submitted for each solicitation required. It is anticipated that a closing date for receipt of proposals for RFP 81093 will be 30 Jun 81 (120)

U.S. Department of Education Office of Procurement and Assistance Management Operations Support Branch ROB#3, Room 5671, 7th and D Street, S.W. Washington, D.C. 20202 Att: Carol Garter.

Mr. SIMON. The next witnesses are Mr. Thomas L. Shaffer of Booz-Allen & Hamilton, and Mr. Edward Hearle, project director for student loan collection with Booz-Allen & Hamilton.

We are pleased to have you both here.

You do not have a statement.

STATEMENTS OF THOMAS L. SHAFFER, PRINCIPAL, BOOZ-ALLEN & HAMILTON, AND EDWARD HEARLE, PROJECT DIRECTOR, STUDENT LOAN COLLECTION STATUS, OPTIONS, AND RECOMMENDATIONS, BOOZ-ALLEN & HAMILTON

Mr. HEARLE. Our work is a 6-week study with essentially two objectives: first, how the debt collection process works, and second, a comparison of the cost-effectiveness of Federal staff as compared to the two prototype collection agencies' efforts, particularly in light of the planned reduction by the end of this fiscal year. That was very present in our analysis.

In terms of the report we presented, a few ball park numbers, $36 billion have been distributed in student loans since 1958, of which $28 billion are in the two programs focused on by the committee, the guaranteed student loan program and the national direct student loan program.

By the end of fiscal year 1980, about $2.2 billion of this was in default, delinquent, or written off. So if one looks at it the other way, some 94 percent of the money is OK.

Delinquency collection efforts accelerated starting in 1977, and collection resources today include 17 employees in the national offices and about 1,100 Department employees in the regional offices.

Results of the accelerated collection program have been substantial since 1977: about $110 million has been collected at a cost of about $49 million. So, there is slightly over 2 to 1 positive cost-effective ratio. That is good news.

There are some problems in the administration of the program which we drew attention to and made recommendations on. There is some fragmentation in the administration of the program. As is often the case in high-priority programs, several people were given high responsibility and there was not sufficient focus so any one person was fully accountable.

Some of the systems designed were not as effective as they could be and some policies were needed in this position and closeout. We have been quite specific as to our suggestions there. There is a backlog of about 816,000 cases. That is a serious problem and a problem to which additional resources should be directed.

In terms of the cost-effective issue of Federal staff versus private collection agencies, no significant difference exists in the cost-effectiveness of Federal and contractor collection efforts. The calculated cost-effectiveness ratio for Federal staff appears to be significantly better than for contract agency collections. The basic numbers suggest that Federal staff collect $3.50 of debt for each dollar of cost incurred, whereas the contractor yield is about $2.20 for each dollar of their cost paid by the Federal Government. However, because contractors have received collection accounts already worked by Federal staff, these ratios are not meaningful. We believe that fully comparable cases would show little difference in cost-effectiveness.

There are some functions that must be done by Government employees in setting up the account and in the final disposition and

closeout. It is the intermediate chasing of the account where there is the choice between private and employee performance.

In terms of our conclusions and recommendations, we divided them into two categories, first those which we felt were important no matter what you do on the private/public issue, and the problems as to mix is between contractor and Federal employment.

First, we feel this should be consolidated. Second, we believe there ought to be a crispening up of the policies on writeoff and disposition. Indeed, some of the backlog would go away, depending on how the disposition and writeoff policies were defined.

And finally, there ought to be improvement in the support systems, not always more automation, but a little more sensitivity to the collection side of the cycle, when the systems are put in place.

On the options between private and public collection, again I emphasize this was done in the context of a planned reduction to a level of 530 by the end of this fiscal year. We have to do that. How can we do it? What will the relative impact be as to the cost? Those were the questions.

So we constructed a benchmark case so to speak and tested the options against it. The benchmark was simple. It said we will dissolve this backlog by the end of fiscal year 1982, and we will have in place by the end of fiscal year 1982 a system for continuing efficient collection of the debts. Then from that benchmark, we defined the options.

The first option would be to continue the current staff, 1,100 Federal employees, through fiscal year 1982. In other words, abandon the notion of reducing to 530 at the end of this year. That would still require contracting out about 330,000 of these backlogged accounts to meet the goal of fiscal year 1982.

Option 2 was the plan the Department was working against, reducing the staff. They consolidate the three regions. It is a fact the students are not remaining in the region where they began. They are scattering in all directions. So there is no great merit in trying to connect collection to a specific region.

The contract effort would be aimed at the backlog.

Finally there is the option of reducing the Federal staff to 530 by the end of this fiscal year, 1981, and 230 by fiscal year 1982. That is the maximum contractor option. Again this would be by consolidating into three regions and using contracting efforts for everything, realizing there is still a role for the Federal employee in the get ready and closeout.

That, sir, is a report on the highlights, and we will be happy to answer questions.

Mr. SIMON. Thank you very much.

I would like to enter into the record the executive summary of your report.

[The information referred to follows:]

EXECUTIVE SUMMARY

Thirty-six billion dollars have been provided in grants and loans since 1958 through five student financial assistance programs.

Guaranteed Student Loan (GSL).

National Direct Student Loan (NDSL).

Law Enforcement Education Program (LEEP).

Basic Education Opportunity Grant (BEOG).

Cuban Student Loan (CSL).

By the end of fiscal year 1980, a total of $2.2 billion in loans and grants were delinquent, in default, or written off. This represents 6 percent of the amount loaned/granted, and indicates that 94 percent of the funds have been or are being repaid, or have not yet become due. The Department of Education has immediate operating responsibility for collecting $835 million of the total $2.2 billion, while the balance is the operating responsibility of lenders, institutions or state Guarantee Agencies.

Delinquency collection efforts accelerated starting in 1977, and collection resources today include 17 National Office and nearly 1,100 regional employees plus two private collection agencies. Results of the accelerated collection program have been substantial—$110 million collected in less than four years, compared to $30 million over the prior decade.

CURRENT OPERATIONS AND PROBLEMS

The current organization of loan collection in the National Office is fragmented and lacks management focus. Three of the four major divisions of the Office of Student Financial Assistance are involved in collection, as are three other staff groups attached to the director. Additionally, there is a collection "team" and quality assurance staff. The result is that no single person is responsible, and a critical mass of collection expertise does not exist anywhere.

The collection process for student loans involves several major steps which are performed quite differently among the five programs. These steps are:

Identification of delinquent accounts, mailing of delinquency letters and posting of delinquent payments.

Initial collection efforts, including postal trace, telephone calls and, where appropriate, negotiation of new payment terms.

Second and third phase collection effort, involving extensive skip-tracing.

Closeout.

The more difficult collection efforts toward the end of the process are primarily the responsibility of the Department. Contractor involvement is found almost exclusively in the "third phase" effort.

Characteristics of collection processing in each program are as follows:

FISL and NDSL processing is handled in each of the ten regions.

The LEEP collection process has not been fully developed.

BEOG grant overpayments are handled in both the National Office and in one region.

Cuban Student Loan collection processing is handled through the Dallas regional office.

The student loan programs use automated systems primarily for billing and not for collection activities. The one fully developed collection system—FISL—is integrated into collection processing but does not fully support the requirements.

COSTS, EFFECTIVENESS AND WORKLOAD

Over the four years ending in fiscal year 1980, costs of Federal staff involved in loan collection have amounted to about $49 million—98 percent incurred in the FISL program. About 65 percent of these overall costs are direct costs for Federal staff and associated expenses in the regional operations while allocated overhead accounts for about 31 percent of total costs. Approximately 2 percent of regional collections costs are devoted to direct support of the two regional contractors.

No significant difference exists in the cost-effectiveness of Federal and contractor collection efforts. The calculated cost-effectiveness ratio for Federal staff appears to be significantly better than for contract agency collections. The basic numbers suggest that Federal staff collect $3.50 of debt for each dollar of cost incurred whereas the contractor yield is about $2.20 for each dollar of their cost paid by the Federal government. However, because contractors have received collection accounts already "worked" by Federal staff, these ratios are not meaningful. We believe that fully comparable cases would show little difference in cost-effectiveness. Regardless of the functions conducted by private collection agencies, the Department is ultimately responsible for final resolution of accounts, and needs to perform several collection activities with its own staff.

Future workload plus backlog clean-up are likely to require both contractor and Federal staff support. Based on historical FISL experience, a standard time of 1 day per completed debt collection case is reasonable. From this standard, plus the backlog and ongoing workload, the number of required collection staff can be estimated.

The current number of unresolved accounts is 816,000, and the Department is expected to receive about 400,000 new accounts in the next three years.

Thus, a total of some 3,300 staff years of effort will be required to eliminate the backlog and process the new accounts received through fiscal year 1983. This compares to about 2,100 available man years now scheduled to be on board during this period, thus creating a need for a total of about 1,200 additional staff years over the next three years.

OPTIONS AND RECOMMENDATIONS

To strengthen the Department's student loan debt collection programs, two kinds of actions should be taken. First, a set of core recommendations should be installed, and, second, a selection should be made from among three strategic program options. The core recommendations are:

Consolidate all National Office collection activities into one division-level organization in the Office of Student Financial Assistance.

Establish an effective writeoff and/or final disposition policy (proposed elements of this policy are suggested in the body of our report).

Establish an effective reporting and monitoring system for routinely evaluating the cost-effectivness of each program.

Obtain contract debt collection agency support consistent with the strategic program option selected.

Improve the efficiency of regional debt collection operations.

In addition to implementing these core recommendations, the Department needs to implement one of the following three strategic program options to clean-up its backlog of unresolved accounts and expeditiously handle new accounts.

Option I—Continue the current staff level of approximately 1,100 through fiscal year 1982 and contract out 333,000 old accounts.

Option II—Carry through with the currently programmed reduction in Federal staff to 530 by the end of fiscal year 1981, consolidate into three regions and contract out almost all of the 816,000 unresolved accounts. New accounts would continue to be worked by Federal staff.

Option III—Reduce federal staff to 530 by the end of fiscal year 1981 and to 230 by the end of fiscal year 1982. Consolidate into three regions and use contract collections on almost all accounts; both backlog and new.

The cost-effectiveness of each of these three options is estimated to be approximately one dollar of cost per $2.00 of loan recovery, with total collections between $180 and $225 million.

Since current ED planning and budget programming will reduce Federal staff resources by more than 50 percent by the end of fiscal year 1981, an immediate decision is needed on one of these options to provide sufficient resources, either contractors or Federal, for the continued effective functioning of the program. Since some contractor support is inescapable, the principal problem is to acquire sufficient resources so the backlog can be eliminated by fiscal year 1982 or otherwise ED must tolerate its existence for additonal years.

Mr. SIMON. What were your instructions when you took on this chore, the instructions from the Department? Did they leave you free? What were your instructions?

Mr. HEARLE. There were none that shaped what we did, other than the objective. The contract statement is in a single sentence: To conduct a study of collection activities under the U.S. Department of Education student financial assistance program, analyze results, and provide recommendations on the operation of future collection activities.

There was the reality of the plan to reduce staff to 530 by the end of fiscal year 1981. The question was: Can we do it in light of the experiment going on, and what are the different ways we can do it?

Mr. SIMON. You talk about a backlog of 516,000 cases and at another time a backlog of 800,000 cases. I have two questions: One is a discrepancy of those figures, and two, how do you enter the backlog? How far behind are you, before you are part of a backlog?

Mr. HEARLE. On the first one, the backlog is 816,000; 300,000 was the number associated with option 1.

Mr. SHAFFER. In general, the backlog definition was the Department's definition. Generally in the FSIL cases, that was the number of cases to be worked, many of which were quite old. In the matter of the NDSL cases, those were the ones turned over to the Department as a result of the institution turning them over to the Department.

In addition there were several smaller programs, BEOG and the Cuban program, which were very much in arrears and were clearly a backlog.

Mr. SIMON. When you calculate costs, do you include Federal retirement costs in there?

Mr. HEARLE. Yes; at the OMB guideline figure.

Mr. SIMON. The one area from my brief scanning through the various statistics that shows a remarkably good record is the San Francisco area. Was there any consideration toward why were tney successful, and can this be applied more universally?

Mr. HEARLE. They are extraordinarily successful, without any question. We were only there a brief time, and Tom can comment on this.

Mr. SHAFFER. Unfortunately we did not have the time in 6 weeks where we had to cover a lot of territory, to see the exact nature of their operations and the why of why it was so effective.

In our report, we raised the fact that it was interesting, but we were not able to take a detailed look at all the regions.

Mr. SIMON. It would appear not too lacking in good sense to look at areas where they are markedly successful and to keep those areas going, and in areas where there is less success, shift things a little more. Is that unreasonable?

Mr. HEARLE. They have a joint effort in San Francisco, they have an employee effort, and it was one of the experimental sites for the contractor effort.

Mr. SHAFFER. We suggested in our report, San Francisco should be considered as a prime collection region, so we did take cognizance of that fact.

Mr. SIMON. Did you take a separate look at the NDSL and GSL statistics?

Mr. HEARLE. We looked at them separately.

Mr. SHAFFER. Although, sir, the only thing we computed the cost-effectiveness on was the FSIL program; the NDSL program there has not been enough experience to pull together the figures, and there was no contractor effort either, so it was not possible to do a cost-effectiveness study.

Mr. SIMON. The private agencies are charging a little less than what a private collection agency might charge. Can that be sustained, do you think, in the contracts that may come out of all this?

Mr. HEARLE. It is hard to know until the bids come in.

Mr. SHAFFER. I think they were dissatisfied with the original arrangements because they were getting accounts that were worked previously fairly hard by Federal collectors, as I understand it.

There are actually two different rates functioning, and they are very different. One is 28 percent, which was actually on the low

side. The other rate was 38 percent in San Francisco, which is a little bit on the high side. So there were really two different rates compared.

Mr. SIMON. What if suddenly Edward Hearle became Secretary of Education and now you have studied this and you had put the program together. Just from the viewpoint of serving the Nation on this problem and serving the Nation effectively, what kind of a mix would you have of the private and public collection?

Mr. HEARLE. Well, it is partly governed by constraints outside this program that I might face in terms of positions that must be reduced somewhere in the Department. The attractiveness from one perspective of looking hard at relying on the private collection agencies here is that there is a private resource out there that can be drawn upon, which is probably not equally true across the whole range of the Department's functions. The experiment I think has been reasonably successful in that the yield has been cost effective and there have not been disasters of collection episodes.

So my own inclination, sir, in response to your question, would be to rely substantially on a private collection operation, although monitored by a small, tight, Federal management staff.

I continue to emphasize the essentiality of having a couple hundred Federal employees doing what needs to be done.

Mr. SIMON. Mr. Weiss.

Mr. WEISS. Thank you very much, Mr. Chairman. I get the sense as I listen to testimony, both today and last time you were here, that there is a feeling on your part that if you had more time, that perhaps you would give us more definitive answers. Is that accurate?

Mr. HEARLE. Yes; a 6-week study done during Christmas and New Year's is not enough time. But we are confident this is a respectable report. On the other hand, we did not study it the first time. Others had studied it before.

Mr. WEISS. If again you were suddenly thrust into being the Secretary or Assistant Secretary in charge, would you in fact ask for further detailed research before you came to a final conclusion?

Mr. HEARLE. No; I do not believe so. I think I would move to implement, because of the time that is available before whatever the implemented option is has to work. I am concerned this has been expressed in the chairman's opening statement about a protracted interim period while the act is occurring. We have to tilt this some way. It is tilted toward contractors, so let us get on with it.

Mr. WEISS. When you or your company were being interviewed to undertake this assignment, was there any discussion as to why it was essential for this study to be undertaken within that very close timeframe you talked about?

Mr. HEARLE. Yes; in the sense that the Under Secretary wanted to have a completed report to give to the incoming Secretary. That was the driving-time horizon.

Mr. SHAFFER. There was considerable concern by the then Under Secretary that in fact this handoff, if it were to occur because there was a congressional mandate as to staff, that this handoff to either private collectors or continuation of private staff could not move on smoothly. There is a fair amount of transition work that had to be done and his instructions to us were, let us see if we can get to the

bottom of this issue so some sort of decision can be made, and also so it does not get lost in the shuffle with a new administration coming in so there are some options to proceed.

Mr. WEISS. In essence, the mandated staff reduction in the Education Act of 1979 really underlaid all this effort, the urgency of the effort.

Mr. HEARLE. Yes; that is correct. It was going to happen by the end of fiscal year 1981 and what should we do with this program?

Mr. WEISS. And the mandate of that law is to reduce staff by some 500 people, right?

Mr. HEARLE. Yes.

Mr. WEISS. And it was the purpose of the study as to whether that could be done and whether the work those people did could be done by private contractors.

Mr. HEARLE. To look at the experiment which had been launched months before to see how it had worked and if it would be extended.

Mr. SHAFFER. This was a very real problem, a potential problem, achieving a personnel reduction. It was to be taken as a possible restraint, and we should look at other plans.

The then Under Secretary made it very clear that even though the Department was in the position of having to reduce 530 positions and the preliminary plans were equipped to do that, in fact that was not a given and we should look at all the options. If it had turned out differently, if it had been shown that Federal collectors were much more cost effective, then you can always come back to the President, the Congress, to relieve the situation or take it from somewhere else in the Department.

Mr. WEISS. As I gather again, in your judgment, it is pretty much a wash. We may or may not disagree with that, but in fact that is your conclusion?

Mr. HEARLE. Yes.

Mr. WEISS. As I think back to when we were discussing the creation of the Department, and I serve on the Government Operations Committee, I recall the insistence of the committee and of just about everybody involved in the process that the Department would not only be responsible for adding additional staff people, but would end up reducing staff people. That is why this particular mandate was written in the law. But what underlaid that was not the reduction of people. What we were concerned about was cost savings or increased costs, one or the other, and it just seems to me what we are doing in this process, if in fact it is a wash, by going off to other employment levels of operation, to private contractors, is at most meeting the letter of the law; that is, we will have a reduction of staff people, but in fact there will be no reduction in cost at all. It seems to me that perhaps you had addressed that, or were you asked to address that at all, or was that beyond the scope of your study?

Mr. HEARLE. We did not look beyond the issue of the 530-person count. As I indicated, there was one option that put that aside and kept the staffing for an additional year. But their thinking was very much, is it possible to carry on the program and reduce it by that number of people while relying on the private collection agency route?

Mr. WEISS. Is it not also possible once the Government has in essence given up its capacity to undertake collection, when more realistic considerations enter into the assessment of costs by the private companies, that you may see an increase in the cost of those contracts?

Mr. HEARLE. I suppose it is possible.

Mr. WEISS. I understand the private contractors are charging 37 and 33 percent respectively for collections, but that most agencies charge a 37-percent minimum and up to 50 percent. So is there not already built into this an unreal estimation of what the ultimate cost may be on a contract basis?

Mr. SHAFFER. We do not believe so. The amount the contractors charge is related to the amount they can get recovered from loans. The way the Department assures itself that it gets the best recovery is through competitive processing and recompeting, if necessary, or whatever, if necessary.

Our understanding is the rates charged on NDSL and other accounts by private collectors or guarantee agencies based on telephone survey, are in the average of 30 percent. So it is possible they could have a higher rate, but I would be very surprised if the Department keeps the process competitive and controls it effectively.

Mr. WEISS. I am just bothered by the possibility and indeed I think the likelihood that you will end up—you know at the very least, the costs will be the same. Yet we in Government are not pretending that in some way we save the taxpayer a lot of money by laying off employees and taking them into the private sector. Ultimately a year or two down the line, somebody will total up what the costs were and we will see we will be in the same place and we will be charged much more for work the Government could have been doing for less. In the meantime, we will have taken a blow at big Government by reducing staff, but we will not have reduced the amount of money taxpayers have to pay for this.

Thank you very much, Mr. Chairman.

Mr. SIMON. May I toss a few other questions in your direction.

Did you take a look at the question of IRS and availability of addresses? We have authorized this for the Federal Government. Obviously IRS would not turn over such addresses to—I do not think they would, anyway—to private collectors.

Mr. SHAFFER. We looked at that as an integral part of the processing, yes. It is an effective technique.

Mr. SIMON. Do you see this as a major barrier for the private collector?

Mr. SHAFFER. It is not clear to me that the Department after it gets the address cannot give the address to the private collector. I can see you would not allow the access of that collector to the files. I think maybe they are doing it, providing the addresses anyway to the collection agency.

Mr. SIMON. Did you take a look at the States or schools under the NDSL program that were successful—that are successful and why they are successful?

Mr. SHAFFER. We just talked to them briefly by phone. That is all we had time to do. They considered that their programs were reasonably successful using collectors and using their own staff in cer-

tain cases. So, again, from the evidence from what we could get only by phone at that point, it appeared either way could be successful.

Mr. SIMON. No pattern emerged from that?

Mr. SHAFFER. No distinctive pattern. It was a random sample of institutions.

Mr. SIMON. Mr. Dean, the minority counsel, have you any questions?

Mr. DEAN. Yes, just one or two.

Did you find employee turnover amongst the private collectors to be a problem?

Mr. SHAFFER. There was some turnover. We did not have time to assess the impact. It was higher. As I recall, it was around 20 to 25 percent.

Mr. DEAN. The second question relates to the fact that the Department apparently is just going to award three contracts. I know that pension funds often award a number of contracts to portfolio managers and let them compete among themselves for subsequent contracts. Do you see any obstacle to doing this with these collections?

Mr. HEARLE. We have not seen the RFP. I think there would be some desirability with multiple contractors.

Mr. DEAN. Have you been consulted in formulating the RFP, formally or informally?

Mr. HEARLE. No; we gave them some notions back in January at the time this report was submitted.

Mr. DEAN. Will you summarize for us what these notions were?

Mr. SHAFFER. It basically went to the fact that alternatives for the Department should consider a first-placement and second-placement basis. We also suggested in fact the cases should be clearly identified as to what kind of cases were they. Had they or had they not been worked before because that makes a difference on the return. There were a number of primarily technical points, and I believe we included some of the considerations.

One of the suggestions was consideration of allowing the collection agencies to use their regional offices. They do have regional offices, but of course that has to be balanced in light of protecting the Federal Government's interest. If they use the regional offices, they cannot be monitored as closely.

Mr. DEAN. What is first placement and second placement?

Mr. SHAFFER. First placement means it has not been worked before, and second placement means it has been worked before, and therefore the collection agency requests a higher rate in order to work it.

Mr. SIMON. You refer to loans as being delinquent or written off. At what point is a loan written off?

Mr. SHAFFER. It is a diffused policy, and that was part of the problem. I believe the Debt Collection Act, or one of the laws guiding it, the guidance is very vague, say something about when it is no longer cost effective to carry the loan, you should write it off. The Department was using a figure under $10 as being the point of writeoff. Another figure, $70 to $80, was also written off after due diligence had been shown in collecting the loan.

There were a lot of loans, $1,000, $1,500 debts that nobody quite knew what to do with. They could not find the people to collect from, or it was too much work, yet nobody was really willing to write this off.

Mr. SIMON. We thank you very, very much for your testimony and for your helpfulness here.

Our next witness is Mr. Thomas Butts, assistant to the vice president for academic affairs, the University of Michigan, and someone who is not unfamiliar to the subcommittee. Our colleague, Mr. Jeffords, will be coming along, and we may interrupt your testimony at some point and get back to you.

STATEMENT OF THOMAS BUTTS, ASSISTANT TO THE VICE PRESIDENT FOR ACADEMIC AFFAIRS, THE UNIVERSITY OF MICHIGAN (FORMER DEPUTY ASSISTANT SECRETARY, DEPARTMENT OF EDUCATION)

Mr. BUTTS. That is no problem, Mr. Chairman. It is a pleasure to be here. This is the first time I have testified before the committee without having testimony cleared by OMB. I must confess it is a unique experience.

Mr. WEISS. It must be a heady feeling.

Mr. BUTTS. Yes. These programs as you well know have had strong bipartisan support and we have had a great deal of concern over the years regarding the credibility of the program in the public mind. The problems with default and other problems of abuse in the program have required that strong steps be taken to insure program integrity. That, I think, was essential in the 1980 amendments when we were debating how to improve the programs and not whether or not they should exist. The fraud-and-abuse efforts which have taken place over the last few years I think have contributed to that particular situation.

I would say, as I move into my brief remarks, that the civil servants that I worked with in the Department were absolutely outstanding, dedicated, and did their very best to operate the programs effectively. My experience was, when you permitted them to use the talents they have, that you get good, cost-effective results.

I am concerned, however, in the last few months with Mr. Bell's statement to the staff that "* * * the collection of student loans is not an integral part of the mission of the Department of Education * * *".

This forward-to-yesterday attitude reminds me of administrations prior to 1977 when the only interest in the programs seemed to be to abolish certain ones by lack of administrative support—thus discrediting them by de facto encouraging fraud and abuse.

My concerns range somewhat further than the area of student loan collections, and I would like to briefly touch on them with your permission, Mr. Chairman. We have seen in the past few months:

Impoundment of the Pell—basic grant—delivery system for 2½ months to make an unnecessary and inequitable change in the family contribution schedule at an estimated cost of $1.5 million.

Changing the family contribution schedule in such a way as to ask most of the poor and the least of middle and upper income.

There has been enough confusion caused in the guaranteed student loan program to cause at least one State—Michigan—to send letters to all lenders telling them not to give students loan applications.

Misleading the committee by saying that $100 million would be added to the national direct student loan [NDSL] program in fiscal year 1982 and not noting that it would be cut by $100 million in fiscal year 1981.

Dismantling the student loan collection force which will result in fewer loans collected from defaulters and reinforce the notion that loans are not loans but grants.

We have seen the referrals of defaulted national direct student loans by institutions as provided for in the law suspended.

Over the years a great deal of criticism about the management of the Federal student financial aid programs has come from both Members of the Congress and from the postsecondary community.

While some of the criticisms may be justified because of previous mismanagement of the programs, a great deal has been done to improve the delivery and management of the Federal student assistance programs and to eliminate fraud, abuse, and waste.

Much, however, remains to be done to insure continued improvements in the management of the student aid programs. I would like to share with you some of my concerns about problems which exist in the Department as they relate to the student financial programs. I hope you will find my comments useful.

STAFFING AND RESOURCES

First, further erosion of resources will cause efforts to combat fraud, abuse, and waste in these programs to be severely impacted.

Since 1978, OSFA has conducted 2,590 institutional program reviews and 4,220 audit resolutions which identified $45.1 million in liabilities to the Federal Government. The restrictions on hiring and the diminishing travel budget meant that last year we did 17 percent fewer education institution reviews than the previous year. To measure the impact of the travel restrictions and staff reductions, or to measure the effectiveness of program reviews, a simple formula can be used: For every $20,000 spent in program review travel, an estimated $1 million in recovery can be anticipated.

OSFA currently has in house more than 2,000 unresolved audits. As resources diminish, only a cursory review of audits can be done.

Second, as one looks at OSFA's staffing, it is necessary to understand the heavy reliance OSFA has on contractors to provide necessary services in the administration of the programs. For example, the contract for processing Pell grant applications provides not only the processing of initial applications, but the handling of data corrections, matches with social security and other data sources, as well as handling the tens of thousands of inquiries from students and the public.

Other contracts are used: One, in the administration of the guaranteed/Federal insured and national direct student loan programs; two, to handle public inquiries about the programs; and three, to conduct program research, analysis, and training.

Third, ED's decision to discontinue using regional attorneys and the transfer of the Division of Compliance to the Office of the Inspector General [OIG] has severely hampered OSFA's regional offices. The transfer of compliance to OIG also left a void that must be taken up by OSFA's program review staff. Without additional resources, unmet needs will also remain in this area. Now that compliance is in OIG, they have chosen to target their attention primarily on criminal cases—not civil.

Fourth, finally, attention must be given to the problems OSFA personnel face in obtaining essential management support and services within ED.

OSFA has been unable to obtain sufficient skilled personnel necessary to: *(a)* develop contract requests for proposals [RFP's]; *(b)* monitor contracts; *(c)* develop and handle necessary accounting functions; and *(d)* develop application and reporting forms that help reduce error and waste.

Mr. SIMON. If I may interrupt you. Our colleague has arrived.

If you do not mind being interrupted, we will get back to you in a minute.

Mr. Jeffords, we look forward to hearing from you.

STATEMENT OF HON. JAMES M. JEFFORDS, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF VERMONT

Mr. JEFFORDS. Mr. Chairman, I want to thank you and the other members of the subcommittee for giving me the opportunity to appear before you this morning.

First of all, I would like to commend the subcommittee for taking up the issue of debt collection. The magnitude of the Federal Government's outstanding debt problem, at all Federal agencies, is astounding. As of the end of fiscal year 1979, of the $175 billion in debts owed, $25.3 billion was in default or delinquent. Moreover, at that time the state of many agency accounting systems was so poor that it was impossible to determine if an additional $2.4 billion was current or overdue. So this is a pressing problem, one that needs to be given top priority and addressed vigorously at the U.S. Office of Education and across the entire breadth of the Federal Government.

I think we are making headway. Administrative savings were called for in both Democratic and Republican budget alternatives. Just yesterday the House passed under suspension of the rules H.R. 2811, which gives Federal agencies the authority to refer the names of defaulted borrowers to credit bureaus. This bill should help the Department of Education. In New Jersey, where the condition of all student loans is made known to credit bureaus, student defaults are relatively few.

But we need to go further. Federal agencies need additional collection tools. I think the administration's plan to use private collection agencies in order to bring defaulted NDSL and FISL loans into repayment is sound. As I understand the plan, roughly one-fourth of the Federal term collectors will be retained by the Office through fiscal year 1982 in three regions, San Francisco, Atlanta, and Chicago. Defaulted accounts will still be reviewed at the Federal level, and Federal employees will still prepare cases for referral

to the Justice Department and for cancellation in the event of death or disablement. But basically, the Federal effort is being scaled back and a new tool, collection agencies, is being made available. The more tools we have, the better.

The use of collection agencies has been reinforced by the GAO in its report entitled, "The Government Can Be More Productive In Collecting Its Debts By Following Commercial Practices." The pilot projects monitored by the Atlanta and San Francisco offices have been successful according to a number of analyses, including one conducted by Booz-Allen & Hamilton. Although it has not been possible to make valid cost-effectiveness comparisons between Federal and private sector collection, private collectors retain a higher percentage of accounts in repayment status and obtain larger monthly payments. A case can be made that the most effective collectors are at work in the private sector, simply because the pay there is higher than what they can expect from Uncle Sam. Finally, I think a private operation can probably be more responsive to fluctuations in the caseload; Federal agencies by nature can be somewhat brontosaurus-like in adjustment to changes.

I certainly do not mean to imply that the Department's term employees have not been effective, because they have been. A keen sense of competition was fostered between regional offices, and the results have been good. We have seen almost $1 million in collections coming into ED per week, or roughly $49 million on an annual basis. But the authority for most of the term appointees does expire as of September 30, 1982, and to a great degree these individuals have done what they set out to accomplish, reduce the backlog of defaulted GSL accounts. Of the more than 600,000 GSL's in default over the past 4 years, more than 90 percent have been resolved.

Although I do support the use of collection agencies, I would like to see an additional step included in the loan collection process. The collection system I favor is included in my debt collection bill, H.R. 2543, which I introduced on March 17 and which currently has more than 50 cosponsors. Title II of the bill provides for a quarterly review of the portfolio of defaulted NDSL and FISL accounts by ED. During these reviews, accounts determined to have been with the Office for 6 months and which are not in repayment would be contracted out, on a competitive basis, for collection by private collection agencies or the State guarantee agencies.

Loans contracted out which have not entered repayment status after 1 year's time would be referred to the Justice Department if the balance is in excess of $600; this provision reflects current practice. Loans with balances of $600 or less would be referred to the IRS for offsetting against tax refunds that might be forthcoming to the taxpayer.

My point here is that some are worried that collection agencies will skim the cream off the top and will not spend much time with accounts that are tougher to crack. I think we need backup procedures, and these should include referral to both the Justice Department and the IRS. The IRS has a very effective collection operation, and I think we will find that a goodly number of the more difficult defaulted borrowers will have tax refunds coming to them.

Again, I congratulate the subcommittee for looking into this subject. To the extent that ED can formulate an effective debt collection system, it can provide very useful guidance to other Federal agencies such as the Veterans' Administration which have sizable default totals in their education loan programs.

Thank you, Mr. Chairman.

Mr. SIMON. Thank you very much. You are the first witness I have had in my 6½ years here who has referred to anything as brontosaurus-like.

The IRS idea that you suggest here, is there any precedent for that?

Mr. JEFFORDS. The only precedent in a sense is the examination of the potential. The General Accounting Office did an analysis, I believe, last year or the year before, which indicated if you take a look at the total Federal debts that are owed, it could have picked up about $4 billion by the use of the refund situation.

That means there are a large number of people that owe the Federal Government money who get back refunds in their checks because of their tax situation.

Now some of those might be hardship cases, but nevertheless it would be an effective tool for recovering a considerable amount of the money owed to the Federal Government.

With respect to the amounts owed the Department of Education, I am not sure whether that was broken down. I guess it was a general 30 percent across the board with respect to different types of loans that could be picked up by the use of the refund system.

Mr. SIMON. Have you had any reaction from either the Department of Education or the IRS to this idea?

Mr. JEFFORDS. The response of the IRS was not with respect to this suggestion, but rather with respect to another attempt, and that was to working in the food stamp areas. But their general feeling is that they are understaffed and have insufficient capacity to take on additional work. I feel that is an unfortunate position to take, for if such a thing were to be productive then the additional number of employees needed would be justified. Four billion dollars is a lot of money.

Mr. SIMON. The Department could, in effect, adopt on its own your idea, could it not, without legislation?

Mr. JEFFORDS. With respect to the proposal——

Mr. SIMON. The 6-month portion of it?

Mr. JEFFORDS. That is correct. It is my understanding they are expected to do a number of these things.

Mr. SIMON. As contracts are handed out, have you any suggestions as to what kind of stipulations ought to be there for private agencies?

Mr. JEFFORDS. Only that obviously, there should be care taken in the type of agencies selected, and there should be guidelines as to the procedures utilized. Having been an attorney involved in this kind of business, obviously, some collection agencies can be ruthless in their approaches, and it should be spelled out what activities will be allowed or proscribed to prevent the abuse of collection agencies to overdo their job.

Mr. SIMON. Mr. Weiss.

Mr. WEISS. Thank you very much, Mr. Chairman.

Mr. Jeffords, welcome.

I think the legislation proposed, if I understand it correctly, is to be commended. Your suggestion is that as far as first efforts are concerned, that will continue to be undertaken by the Department itself.

Mr. JEFFORDS. That is correct.

Mr. WEISS. Only after failure for some 6 months would it be turned over to private collectors for subsequent efforts?

Mr. JEFFORDS. Right.

Mr. WEISS. Have you any estimate as to the percentage of the collections that would be completed by the Department and what percent would be farmed out to private collectors?

Mr. JEFFORDS. All I can say is that the recent efforts have been successful, so the number would not seem to be substantial in terms of overall numbers. I would think the agency itself, if it continues present efforts, although there is a move to cut back on the number of people collecting, would collect a substantial amount of the money, if not the majority of it.

Mr. WEISS. Have you any estimate as to the numbers of staff people, permanent or temporary, who would have to be kept on by the Department to complete that first collection effort?

Mr. JEFFORDS. No; I do not. We can furnish that information to the Department.

Mr. WEISS. Thank you very much, Mr. Chairman.

Mr. SIMON. Mr. Dean.

Mr. DEAN. In preparing this legislation, did you assess the impact of having IRS involved as a factor in motivating people to repay their student loans? Do you think that would increase the number of students who would repay them?

Mr. JEFFORDS. I think that would cause a tremendous change in people having to repay their loans, just the fact these tools are available.

What we have seen, unfortunately, is an awareness of those we would want most to pay back their loans that they do not have to pay them back; that the ones you would want to give the best deal to are the ones who get the worst of the situation. I think going to a private collection agency or going to the IRS would probably do as much as all the collectors put together.

Mr. DEAN. Thank you very much.

Thank you, Mr. Chairman.

Mr. SIMON. Do you have any feel for the numbers of people who would be needed, assuming the 6-month provision?

Mr. JEFFORDS. We would be happy to try to provide that information, Mr. Chairman.

Mr. SIMON. I assume there are representatives of the Department here. My first-blush reaction to your proposal is similar to Mr. Weiss', that one of the questions we will direct to the Department when they testify on Thursday is their reaction to your proposal.

We appreciate your leadership and initiative on this and thank you for your testimony.

Mr. JEFFORDS. Thank you. I would like to add, when I was attorney general in the State of Vermont, I got into some of these collection efforts and found them to be very beneficial as to the cost ef-

fective situation. In the social welfare area, 10 to 1 or 20 to 1 for dollars spent. So I would like to emphasize that comes not only from observation as to what has occurred, but from what can occur.

Mr. SIMON. I notice in your testimony you suggest the possibility of turning these defaulted loans over to State agencies, also, which is an intriguing possibility that had not occurred to me, frankly.

Mr. JEFFORDS. Yes, there is a general feeling the closer the agency to the people involved, the more the motivation for people to repay and for those agencies to collect the money.

Mr. SIMON. We thank you again, very, very much.

Mr. SIMON. Tom Butts, again, our apologies.

Jim, you owe the University of Michigan a special vote on something, because you interrupted their testimony here.

Mr. BUTTS. Thank you for that, Mr. Chairman.

I think the interruption was most appropriate. The recommendation that I left the Department with was basically what Mr. Jeffords is proposing, that is that the Federal work force work the loan for 180 days, following prescribed procedures in steps they would go through, essentially those followed by the San Francisco regional office.

Following that time, the loan would be referred directly to a collection agency, possibly to a second collection agency. If the collection agency failed to collect as they frequently do, and there is always the danger they will give up when they see it will not be cost effective, it will then be returned to the Department or referred to the Justice Department for litigation.

It should be noted in the last 3 years we have referred over 27,000 cases to the Justice Department for prosecution. In the entire history of the guaranteed loan program before that time, only 500 cases had been referred to litigation.

I would like, in closing, since the rest of my testimony is background, I think, and you may want to ask me questions about it, I want to make clear that I believe the effective management of all aspects of the title IV programs is an integral part of the mission of the Department of Education.

As a consequence, if there must be reductions in staff and operating expenses, priorities have to be established within the Department to assure the programs can function effectively. I believe, therefore, that it is essential that priority for funding be given to processing contracts and support staff, fund training, and public inquiry contracts and support staff and all efforts to eliminate fraud and abuse. If cuts must be made, there is ample room in nonprogram staff and expenses to achieve reductions. This will be more painful than firing temporary help which happens to have been proven to be effective, but in a long run will make for a streamlined, more efficient development.

In closing, Mr. Chairman, I would like to share with you a quotation presented to me by the State guarantee agencies last year. We all got along but we did have our differences of opinion and the quote, I think, is appropriate: "We trained hard, but it seemed every time we began to form up into teams, we were reorganized. I was to learn later in life, that we tend to meet any situation by reorganization. A wonderful method it can be for creating the illu-

sion of progress while producing confusion, inefficiency, and demoralization."

Thank you. I will be happy to answer your questions.

[The prepared statement of Thomas A. Butts follows:]

PREPARED STATEMENT OF THOMAS A. BUTTS, FORMER DEPUTY ASSISTANT SECRETARY FOR STUDENT FINANCIAL ASSISTANCE, DEPARTMENT OF EDUCATION

Mr. Chairman and Members of the Subcommittee: I appreciate your invitation to speak with you today regarding the collection of student loans and other issues related to maintaining public confidence in the integrity of the Title IV student assistance programs.

Since 1977 we have seen a marked improvement in the management and control of abuse and waste in the programs. However, Secretary Bell's memo to staff stating that ". . . the collection of student loans is not an integral part of the mission of the Department of Education . . ." causes me great concern.

This "forward to yesterday" attitude reminds me of administrations prior to 1977 when the only interest in the programs seemed to be to abolish certain ones by lack of administrative support—thus discrediting them by defacto encouraging fraud and abuse.

Since January, 1981, my concern has been reinforced by the following actions by the administration:

Impoundment of the Pell (Basic Grant) delivery system for two and one-half months to make an unnecessary and inequitable change in the family contribution schedule at an estimated cost of $1.5 million.

Changing the family contribution schedule in such a way as to ask most of the poor and the least of the middle and upper income.

Cause enough confusion in the Guaranteed Student Loan Program to cause at least one State (Michigan) to send letters to all lenders telling them not to give students loan applications.

Misleading the Committee by saying that $100 million would be added to the National Direct Student Loan (NDSL) program in fiscal year 1982 and not noting that it would be cut by $100 million in fiscal year 1981.

Dismantling the student loan collection force which will result in fewer loans collected from defaulters and reinforce the notion that loans are not loans but grants.

Suspend the referrals of defaulted National Direct Student Loans by institutions as provided for in the law.

Over the years a great deal of criticism about the management of the Federal student financial aid programs has come from both Members of the Congress and from the postsecondary community.

While some of the criticism may be justified because of previous mismanagement of the programs, a great deal has been done to improve the delivery and management of the Federal student assistance programs and to eliminate fraud, abuse, and waste.

Much, however, remains to be done to insure continued improvements in the management of the student aid programs. I would like to share with you some of my concerns about problems which exist in the Department as they relate to the student financial aid programs. I hope you will find my comments useful.

STAFFING AND RESOURCES

1. Further erosion of resources will cause efforts to combat fraud, abuse, and waste in these programs to be severely impacted.

Since 1978, OSFA has conducted 2,590 institutional program reviews and 4,220 audit resolutions which identified $45.1 million in liabilities to the Federal Government. The restrictions on hiring and the diminishing travel budget meant that last year we did 17 percent fewer education institution reviews than the previous year. To measure the impact of the travel restrictions and staff reductions, or to measure the effectiveness of program reviews, a simple formula can be used: For every $20,000 spent in program review travel, an estimated $1 million in recovery can be anticipated.

OSFA currently has in house, more than 2,000 unresolved audits. As resources diminish, only a cursory review of audits can be done.

2. As one looks at OSFA's staffing, it is necessary to understand the heavy reliance OSFA has on contractors to provide necessary services in the administration of the programs. For example, the contract for processing Pell grant applications provides not only the processing of initial applications, but the handling of data correc-

tions, matches with Social Security and other data sources, as well as handling the tens of thousands of inquiries from students and the public.

Other contracts are used: (1) in the administration of the Guaranteed/Federal Insured and National Direct Student Loan programs; (2) to handle public inquiries about the programs; and (3) to conduct program research, analysis, and training.

3. ED's decision to discontinue using regional attorneys and the transfer of the Division of Compliance to the Office of the Inspector General (OIG) has severely hampered OSFA's regional offices. The transfer of Compliance to OIG also left a void that must be taken up by OSFA's program review staff. Without additional resources, unmet needs will also remain in this area. Now that Compliance is in OIG, they have chosen to target their attention primarily on criminal cases—not civil.

4. Finally, attention must be given to the problems of OSFA personnel face in obtaining essential management support and services within ED.

OSFA has been unable to obtain sufficient skilled personnel necessary to:

a. develop contract requests for proposals (RFPs);

b. monitor contracts;

c. develop and handle necessary accounting functions;

d. develop application and reporting forms that help reduce error and waste.

Unlike the old HEW structure, within the new Department there was a much closer working relationship between senior budget and planning officers and program personnel. Territorial disputes, however, continually result in management taking away resources from program offices.

With the separation from HEW, there are inadequate numbers of trained personnel in contracts and procurement management. This is seemingly not the case in grants management. This results in excessive delays in contract awards and limited contract monitoring by ED contract personnel.

There has existed for many years a need to streamline OE's and now ED's finance system to accept and support the huge sums and manner in which monies are distributed through OSFA. The need for this streamlining has been the subject of several reports and studies. While attention was paid briefly to this issue during the transition, no substantial improvements have taken place. The needed improvements have grade and staffing implications that have, heretofore, precluded necessary changes.

The area of GSL claims fund control has been the subject of repeated GAO and independent studies. The handling of hundreds of millions of dollars is woefully inadequate. OSFA had established a special team to develop and recommend critically needed changes. ED support will be necessary to implement many of these changes. Several changes will have direct impact upon ED's finance structure and OSFA organization needs.

Mr. Chairman, following are a listing of problems in the student loan programs and actions taken during the past several years.

GUARANTEED STUDENT LOAN PROGRAM

Problem.—More than 400,000 GSLs in default.

Action.—Beginning in October 1977, a major effort was begun to recover funds.

a. The latest address of all defaulted borrowers was obtained from the Internal Revenue Service.

b. Letters were sent to virtually all student defaulters announcing the Government's intention to collect.

c. Congressional approval was obtained to reprogram funds to increase the number of Federal collectors, to improve computer support, and to train financial aid administrators.

d. Almost 1,000 term collectors were recruited, hired, and trained to handle the defaulted loan backlog in both the GSL and NDSL programs.

e. A Pre-Claims Assistance program was implemented for lenders, which has been successful in reducing potential claims.

Since fiscal year 1977, the following amounts have been collected from defaulters of federally insured student loans:

Fiscal year:	*Millions*
1977	$9.6
1978	15.7
1979	42.1
1980	42.7

As of December 1980, a total of 50,446 accounts have been closed due to death, disability, or bankruptcy, and 30,972 accounts have been written off. Also, 76,834 accounts have been paid in full, for a total or 158,252 completions.

Two pilot contracts were awarded to private collection contractors to test the effectiveness of private agencies in collecting student loans.

Problem.—Ineffective billing system.

Action.—A computerized billing system was installed in all regions by May 1978.

Problem.—Cases not referred to U.S. Attorneys.

Action.—In the past four years more than 27,000 cases have been referred to U.S. Attorneys, compared to a total of 500 over the previous history of the program.

Problem.—Office of Education's delay in processing of lender claims.

Action.—Efforts were initiated to reduce time between when banks file claims for defaulted loans and HEW's payment on its guarantee. As of June 30, 1978, processing time had been decreased from as long as two years to an average of 30 days.

Problem.—Lenders not exercising due diligence.

Action.—Published regulations which defined responsibilities of lenders in taking thorough and aggressive action in servicing and collecting loans.

Initiated a pilot program in pre-claims assistance to lenders in the San Francisco region. The pre-claims assistance project is designed to help lenders bring their delinquent accounts into repayment status so that they do not become default claims against the Government.

NDSL PROGRAM

Problem.—700,000 NDSLs in default.

Action.—Required schools to submit data on default rates.

Published regulations requiring institutions to exercise due diligence in collecting loans. The Department will take action to limit, suspend, or terminate the participation of those institutions not exercising due diligence.

In April 1978, OSFA began implementing a provision of the Education Amendments of 1972 which allows institutions to assign and refer to the (Office of Education) Department loan notes in default for more than two years. As of December 1980, approximately 278,000 defaulted notes were received from schools.

Of the loans received from participating institutions during the 1979 submission period (238,000), the ten regional offices of OSFA have initiated collection action on approximately 50,000 of these accounts. As of December 1980, the total dollars collected on these accounts was $3.9 million. As of the same date, 15,000 accounts had been converted to repayment, 3,380 had been paid in full, and an additional 350 had been cancelled due to death, disability, or bankruptcy. Regional offices succeeded in recovery of these amounts despite reductions in resources, a lack of computer support, and the continuing effort to collect on defaulted loans in the GSL program.

Offered technical assistance through special workshops to help institutions improve student financial aid administration.

Annually, OSFA reduces Federal capital contributions to institutions with high NDSL default rates that do not show improvement. In 1979–80, more than $3 million was redistributed to other institutions as a result of this action.

Problem.—Excess cash on hand at participating institutions.

Action.—OSFA sent a letter to institutions explaining their obligation to withdraw from their cash account with the Department only those funds needed for loan operations during the next 30 days.

OSFA monitors the amount of excess cash in institutional loan funds and requires at least an annual repayment of excess cash. Such funds revert to the U.S. Treasury.

OSFA added a requirement to the NDSL Audit Guide which requires institutions to make a cash flow analysis.

Mr. Chairman, I believe that effective management of the Title IV student assistance programs is an integral part of the mission of the Depatment of Education. As a consequence, if there must be reductions in staff and operating expenses, priorities should be established to assure that the programs can function effectively. I believe it is essential to:

Fund processing contracts and support staff.

Fund training and public inquiry contracts and support staff.

Support all efforts to eliminate fraud and abuse.

If cuts must be made, there is ample room in non-program staff and expenses to achieve reductions. This will be more painful than firing temporary help which has proven to be effective, but in the long run it will make for a streamlined, more effecient department.

In closing, Mr. Chairman, I would like to share with you a quotation presented to me by the State Guarantee Agencies last year: "We trained hard . . . but it seemed every time we were beginning to form up into teams, we were reorganized. I was to learn later in life that we tend to meet any such situation by reorganizing. A wonderful method it can be for creating the illusion of progress while producing confusion, inefficiency, and demoralization."—Gaius Petronius, Roman author, 66 AD.

Thank you for asking me to be with you today. I would be happy to answer any questions you might have.

Mr. SIMON. Thank you. Incidentally, it is a good quote. My observation from some years in State and Federal government is, if you have the wrong kind of structure and the right kind of people, you have a great program; and if you have a great structure and the wrong people, you have a terrible program.

You are aware of the Booz-Allen report.

Mr. BUTTS. Yes.

Mr. SIMON. What are your reactions to it?

Mr. BUTTS. I think it is a responsible report. I concur with the recommendation. We are in the process of establishing a collection branch or division in the Department to be a focal point.

As the program developed, my predecessor, Leo Cornfield, who deserves a lot of credit for this, set the program up and personally supervised it. As it became operational, it was made a part of the regular program operation. So I would support a branch or division of student loan collections and student loans.

With regard to writeoff policy, I certainly concur with that. As I recall, we published one and sent it to the regions in December.

With respect to improving the systems, we can always improve the systems, and we concur with that.

With respect to the relationship between contracting and Federal employees, I think Mr. Jeffords' plan has much merit. My estimate was that we could, with about 600 term employees down from nearly 1,100 authorized, be able to operate such a plan with a mix of contractors and so forth. It would not, of course, achieve the personnel reductions of the collection force that was mandated by the Department of Education Act and I presume further staff reductions that may have come forward from OMB since I left.

Mr. SIMON. This is digressing for a moment, but on page 11 of your testimony, you talk about the excess funds on hand, excess cash on hand from the NDSL program. Barring the Second Coming, this subcommittee is going to be faced very shortly with a task of massively cutting back on funding of student programs.

What kind of money are we talking about, when you talk about this excess cash on hand, and is this a possible source for——

Mr. BUTTS. That dollar amount I would have to check. What was operating was schools had authorized large sums of Federal capital contribution and drew it down, but then did not loan it out. These were schools that were close to revolving status each year. Basically what we said was, if you do not need the new Federal contribution to add to your reserve fund you cannot draw down more than a 30-day supply at a time. So any savings that might have been achieved by that have already been taken into account and redistributed to other institutions.

Mr. SIMON. So as far as you know, there is no substantial amount that can be saved in this area?

Mr. BUTTS. No. The money that has been brought in has been recycled. The demand for NDSL clearly exceeds the appropriation.

Mr. SIMON. What is the process by which the institution gets funds? That is something I should know, but do not. They apply; how long after they make the application do the funds get to that institution?

Mr. BUTTS. The program is forward-funded and the schools submit their applications in early October along with their fiscal operations report for the prior school year.

In December computer edit reports are sent to the schools to verify the information.

In January, tentative allocations are made; this year with the $186 million. You have probably gotten cards and letters as to distributional effects of that.

Then there is an appeal process, and final awards will typically be sent to schools in May, maybe late—I heard yesterday, maybe June. The schools may begin dispersing the money then, on July 1. But they have a pretty good idea in January what their allocation will be and at that time start making commitments to students.

Mr. SIMON. The travel restriction on page 4, in other words if we allocated just a little bit more for travel, we could be increasing, substantially, the net income?

Mr. BUTTS. Yes, sir, the history of the past 3 years will support that. If you have staff who are trained to review institutions but cannot go out to institutions to review them, the job cannot be done. Now in Boston, it is not much of a problem because most of the schools you can get to by subway. But when you are working in Denver, Atlanta, and other places, it takes planes to get there. If you have highly skilled program reviewers and if they are sitting around not reviewing programs, schools in the immediate area get all the attention and the others are lost, money is lost through the collection effort. Biannual audits more than pay for the expenses of secondary education.

Mr. SIMON. If we added $100,000 we could get an additional $5 million?

Mr. BUTTS. I would hope as the effort continues, you would see less liabilities. That is why I stress the importance of training in the sense of preventative maintenance for the program.

Mr. SIMON. Then the other point, you say OFSA currently has in-house more than 2,000 unresolved audits, only cursory review audits can be done. This number is growing?

Mr. BUTTS. The staff in the audit resolution branch has done a monumental job in getting the audits resolved. If you compare the 4,000 or 5,000 they have done to previous resolutions, it is an impressive record. But the Department has placed a requirement that this be resolved on a biannual basis. Consequently if they are not given additional staff resources, you will get either a cursory review or the backlog will get out of hand.

Mr. SIMON. What if suddenly Tom Butts became the Secretary of Education? "Secretary Butts" has a little bit of a familiar ring to it——

Mr. BUTTS. Once is enough, thank you.

Mr. SIMON. What would you do? What kind of a mix would you have? And would you be going into the private sector at all?

Mr. BUTTS. To the extent it was cost effective. One thing I have learned as people jawboned and said the Government employees cannot be efficient, and my attitude has changed over the 3 years I worked there, Government employees can be efficient. It depends on the nature of the task that needs to be done.

In the basic grant program I think we have been very successful with contracting. In the student loan area, there you have 1,500 employees at certain points working for the contractor and nobody pays any attention to that, because they do not appear on the budget.

In the area of student loans, we did build with Federal employees a reasonably efficient and cost-effective operation. So, you have to balance those.

It is important that public officials in the Department maintain essential control of policy and basic operations in order that the objective balancing of competing interests and forces can take place, the role of the Department as we get into policy issues, where you have competing sectors in the higher education community and so forth, with different interests, have someone approaching the issues, not from the point of view of having anything special to gain one way or another, but a public mandate to be fair to everyone.

Mr. SIMON. Mr. Weiss.

Mr. WEISS. Do you believe the Office currently has sufficient expert staff to monitor three additional contracts?

Mr. BUTTS. No; I believe they need additional staff in the contracts office, and also within the Office of Student Financial Assistance, to monitor contracts. You need probably to go outside to hire people who are experienced in that.

As you recall when the Department of Education was set up and the negotiations went back and forth between HHS and Education, my view is Secretary Schweiker got the 500 people that were to be cut, but that is another matter.

I think one person experienced in systems contracts came over; the basic grant is a $26 million a year operation. There needs to be additional experienced people to assist in the monitoring of the contracts in my opinion.

Mr. WEISS. Can you quantify that as to how many people will be needed for the three contracts?

Mr. BUTTS. No, sir, because I never gave serious thoughts to three contractors, or I never had to, at least.

Mr. WEISS. What do you perceive to be the major reason behind the Department's decision to contract out?

Mr. BUTTS. I think at this time they are under extreme pressure to reduce visibility of Federal employees. These employees are not paid from normal S. & E. funds but from the student loan fund, which is where the collections happen to go. But they are Federal employees and they are there. It is one way to meet the 500 mandate to reduce people and any other possibilities.

When I recommend that serious consideration be given to looking at other parts of the Department where you do have career people, I recognize that is a very tough thing to do, because it means RIF's possibly and that means people being bumped all over and certain kinds of problems. But I certainly feel when the De-

partment was set up, from my own personal point of view, the Congress did not have in mind firing temporary people in an area where there is a special congressional mandate. Indeed, they thought they should have fired other folks who were permanent people.

Mr. WEISS. As a matter of fact, at the time that H.R. 2434 was passed, there were a whole series of program areas where there were recommendations or assumptions of cuts to achieve savings of $15 million. But in none of those statements and assumptions were collections mentioned. Were you involved in those discussions?

Mr. BUTTS. No, sir, I managed the Office of Student Financial Assistance.

Mr. WEISS. Does it come as somewhat a surprise to you?

Mr. BUTTS. Quite frankly I had not criticized the law and would probably have made stronger arguments had I had the information you indicate now.

Mr. WEISS. Can you indicate something about the decision to terminate temporary employees? Was it simply the easiest way to go?

Mr. BUTTS. In all candor, Mr. Weiss, the decision to reduce to, I think, 350 was not one that we were consulted to any extent about. It was one which within the Department there were strong arguments both ways. The management people carried forth that recommendation to OMB. However, as the facts emerged and agreement was not reached, I think the Under Secretary took a very responsible position to say we want to follow good management principles, but we also have to deal with the 500. At which point he commissioned Booz-Allen to do its study rather than to move ahead at that time.

So, within the program and within the Department when all the issues reached senior management, the Under Secretary, I think there was sufficient concern about the sudden reduction and the fear of falloff in collections that a delay of some sort seemed to be warranted.

Mr. WEISS. Thank you.

Thank you, Mr. Chairman.

Mr. SIMON. Mr. Dean.

Mr. DEAN. No questions.

Mr. SIMON. We thank you very, very much for your testimony and wish you the best at the University of Michigan. The University of Michigan may need it this coming year.

Mr. BUTTS. We are having our financial problems.

Mr. SIMON. The subcommittee stands adjourned until 11 o'clock tomorrow.

[Whereupon, at 11 a.m., the subcommittee adjourned, to reconvene at 11 a.m., Wednesday, May 20, 1981.]

[Material submitted for inclusion in the record follows:]

HOUSE OF REPRESENTATIVES,
COMMITTEE ON EDUCATION AND LABOR,
Washington, D.C., May 18, 1981.

Ms. VICKI J. BAKER,
Director, Student Financial Aid,
The George Washington University, Washington, D.C.

DEAR MS. BAKER: Thank you for your joint letter, with Ms. Hoch, regarding the Department of Education's decision to shift from a system of Federal collectors to almost exclusive reliance on private collection agencies. I share your concern about

the effects of this precipitous shift, with concrete justification or assurance that private collectors will get the job done.

I appreciate your willingness to provide your views and a different perspective on the efficacy of the Department's decision.

Cordially,

PAUL SIMON, *Chairman.*

THE GEORGE WASHINGTON UNIVERSITY,
Washington, D.C., May 8, 1981.

Chairman PAUL SIMON,
Subcommittee on Postsecondary Education,
Cannon House Office Building, Washington, D.C.

DEAR SIR: We wish to comment on the proposed changes to the Claims and Collections Division of the Department of Education.

Although we sympathize with the goal of the Department of Education to cut costs, we feel that the elimination or reduction of the Claims and Collections Division will not achieve the desired results. The success which the federal collectors have had in resolving the defaulted loans has been truly remarkable. Based on our experience, we cannot envision a private collection agency that would be able to match the accomplishments of the Claims and Collections Division for a significantly lower cost.

The University in the past has employed six different collection agencies. Some were local, and some national. All proved unsatisfactory for the same reasons. They were ineffectual, inefficient and expensive. We are now in the process of phasing out all ties to our remaining collection agency. Delinquent accounts are being worked in-house and, if necessary, are being referred to an attorney.

Many schools, however, do not have the resources and staff that are available to The George Washington University. These schools depend on the assistance provided by the Department of Education, especially with regard to the referral program, which has lowered their default rates. Collection agencies, which have already worked most of the referred loans, have been unable, in the past, to contribute significantly to a reduction in the delinquency rate.

To replace a system which has proven effective with one that has been so ineffectual in our experience does not seem to be cost-effective. Instead, it may cost the taxpayers more per loan actually collected. If collection rates fall, the funding levels of the schools could drop, thereby reducing the financial aid available to future students. We cannot believe that these are goals that the Department of Education wishes to achieve. Surely there must be some less crucial area in which the Department of Education can save.

Sincerely,

VICKI J. BAKER,
Director.

RUTH R. HOCH,
Loan Collection Office, Student Financial Aid.

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